

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 94-304-W - ORDER NO. 1999-147

MARCH 1, 1999

IN RE: Application of Upstate Heater Utilities, Inc.)	ORDER
for Approval of an Increase in its Water Rates)	ON REMAND
and Charges.)	

✓ MR

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the December 9, 1998 Order of the Circuit Court which remanded this Docket back to the Commission for reconsideration. The Commission had previously issued Order Nos. 94-1279 and 95-151, which denied the request of Upstate Heater Utilities, Inc (Heater or the Company) for an increase in its rates and charges. Pursuant to the Circuit Court's first Order remanding the matter to the Commission, the Commission re-examined the case and granted an increase in the Company's commodity charge in Order No. 95-1491. After requesting reconsideration, Heater appealed once more to the Circuit Court, which once again remanded the matter back to us for further consideration. We subsequently issued Order No. 97-232 in this Docket, which further explained our prior holdings. After requesting reconsideration once again, however, Heater appealed to the Circuit Court for a third time, alleging that we had granted the Company an inadequate operating margin, and had committed various other errors of law. The Circuit Court then remanded the matter back to us again through its December 9, 1998 Order for

further consideration. The Circuit Court indicated that the only relevant facts concerning the fair return or operating margin are contained in the Company's testimony.

Accordingly, we will follow the dictates of the Court and issue this Order on Remand, even though we disagree strenuously with the Court's findings. We would note that the Company's name has been changed since our initial Orders in this case to Utilities of South Carolina, Inc. as a consequence of a corporate merger. For convenience, however, we will continue to refer to the Company as Upstate Heater Utilities, or, simply, the Company, throughout the course of this Order.

FINDINGS OF FACT

Based upon the Application, the testimony and exhibits received in the evidence at the hearing, and the entire record of these proceedings, the Commission now makes the following findings of fact:

1. Upstate Heater Utilities, Inc., is a water utility providing water service in its service areas within South Carolina, and its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. Section 58-5-10, et seq. (1976, as amended).
2. The appropriate test period for the purposes of this proceeding is the twelve-month period ending March 31, 1994.
3. By its Application, the Company is seeking an increase of its rates and charges for water service of \$71,309 which Staff has calculated to be \$71,836.
4. The appropriate per book operating revenues for the Company for the test year under present rates are \$364,341. The operating revenues as adjusted are \$350,237. After the increase granted by us, operating revenues shall be \$422,073.

5. The appropriate per books operating expenses for the Company's South Carolina operations for the test year per book under its present rates is \$308, 087. As adjusted, total operating expenses are \$322,418. After our granted increase, expenses shall be \$349,077.

6. The Company's appropriate level of net operating income for return per books is \$56,864. As adjusted, it is \$28,121. Net income after our granted increase is \$73,787.

7. A year end, original cost rate base per books of \$792,313. As adjusted, and after our granted increase, rate base is \$863,381.

8. The Commission will use the operating margin as a guide in determining the lawfulness of the Company's proposed rates and the fixing of just and reasonable rates.

9. A fair operating margin that the Company should have the opportunity to earn is 10.42% which is produced by the appropriate level of revenues and expenses found reasonable and approved herein.

10. The rate designs and rate schedules approved by the Commission as described herein are appropriate and should be adopted.

11. The rates and charges depicted in Appendix A, attached herein, and incorporated by reference, are approved and effective for service rendered on and after the date of this Order.

EVIDENCE AND CONCLUSIONS

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company's business and legal status is contained in the Company's Application and in prior Commission Orders in the Docket files of which the Commission takes notice. This finding of fact is essentially informational, procedural, and jurisdictional in nature, and the matters which it involves are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 2 AND 3.

The evidence for these findings concerning the test period and the amount of the revenue increase requested by the Company is contained in the Application of the Company and the testimony and exhibits of the Company's witnesses.

The Company's filing was based on a test period consisting of the twelve months ending March 31, 1994. The Commission Staff and the parties of record herein likewise offered their evidence generally within the context of that same test period.

A fundamental principle of the ratemaking process is the establishment of a test year period. The Commission finds the twelve months ending March 31, 1994, to be the reasonable period for which to make its ratemaking determinations herein.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4.

The evidence for the findings concerning the level of operating revenues is found in the testimony and exhibits of Company witness Hilburn and Commission Staff witness Hulton. For purposes of this proceeding, the appropriate operating revenues for the Company for the test year under the present rates per book is \$364,341. Using the Commission's Finding of Fact No. 9 and the Evidence and Conclusions, infra,

Approving a 10.42% operating margin, the Company's operating revenues shall be \$422,073.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 5, 6, AND 7.

Operating expenses per book for the test year were \$308,087 as reflected in the testimony of Company witness Hilburn and Staff witness Hulion. The Commission hereby approves all adjustments as agreed upon between the Company and the Staff. The adjustments on which the Company and the Staff differ are discussed as follows.

The Company proposed an adjustment of \$8,357 to operating and maintenance expense, and a (\$5,758) adjustment to general expenses to annualize salaries and wages based on current levels. Staff proposed an \$8,772 adjustment to operating and maintenance expenses, and a (\$6,302) adjustment to general expenses for said annualization. Although the differences between the Company and the Staff are insignificant, we hereby adopt the Staff's adjustments, since its figures were updated and documented during the course of the audit of the Company by the Staff.

The Company proposed an adjustment of \$980 to adjust the gross receipts tax to the proper level. Staff recommended an adjustment of \$1,486. The Company employed the September 1993 tax rate of .83 to develop its proposed adjustment. Staff calculated the tax using the most current gross receipts tax rate available at that time, the .975 rate of September 1994. Since Staff used the most current rate available, we adopt Staff's adjustment.

The Staff and the Company proposed to adjust miscellaneous expenses to reflect the year end level. The Company recommends an adjustment of \$44, and the Staff, an

adjustment of \$37. The Commission adopts the Staff's adjustment, since Staff correctly eliminated a \$7 fee for job search, which should not be chargeable to the ratepayers.

Both Staff and Company proposed to amortize rate case expenses over three years. The Company recommends an adjustment of (\$5,380), whereas Staff recommends an adjustment of (\$8,660). The Commission adopts the Staff's adjustment, since the Company used estimated expenses, and Staff used actual expenses obtained during the audit. We disagree with the Consumer Advocate's proposal to eliminate expenses associated with this proceeding, since we think they are appropriately recovered.

Both Staff and Company proposed to record the effects of annualizing depreciation expense. The Company recommends an adjustment of \$10,429, whereas Staff recommends an adjustment of \$9,961. After consideration of the calculations of both Staff and the Company of this expense, we conclude that the Staff's calculation most correctly states the proper amount of the expense.

Staff proposes to record the effects of interest synchronization on income taxes, and proposes an adjustment of \$8,469. The Company's adjustment of zero is based on the proposed adjustment to interest expenses. The Commission adopts Staff's adjustment as the more accurate, since it gives the Company tax coverage for the interest on debt associated with rate base increases. Here, Staff's adjustment is clearly advantageous to the Company.

Staff proposes to compute the effects of customer growth based on as adjusted net operating income, and recommends an adjustment of (\$308). The methodology utilized by Staff to compute customer growth for the test year is shown on page 13 of the exhibit of the Accounting Department, which is a part of the record in this case. This is applied

to adjusted net operating income to arrive at the recommended Staff adjustment. Since we believe that it is advantageous to the company to apply a customer growth factor in that this attempts to account for known and measurable growth, we adopt Staff's adjustment.

The Staff and Company both propose to true-up income taxes based on as adjusted taxable income. The Company proposes an adjustment of \$14,811, Staff recommends an adjustment of \$6,342. The Company arrived at its figure by calculating negative income taxes, since there is an operating loss after interest expense. Staff calculated its figure based on zero taxes. We see no advantage to anyone to allow the Company to include a negative income tax figure. The Commission therefore adopts Staff's adjustment.

Both Staff and the Consumer Advocate recommended an adjustment for unaccounted for water down to the Heater of Seabrook Standard of 7.54%. We agree and adopt this standard and this adjustment for this case.

We recognize and are mindful of the fact that both the Consumer Advocate and Chester Kapp propose various other adjustments in this case. However, in view of the fact that the Court held that we must award an operating margin in line with that proposed by the Company, we find that we may not unfortunately consider those adjustments for use in this case unless they are in concert with those adjustments proposed by the Company and the Staff. If said adjustments are in concert, we hereby recognize them as supporting evidence in this case for our findings.

We therefore hold that the total operating expenses for the test year as adjusted from the books figure is \$322,418. After our granted increase, total operating expenses

are \$349,077. Net operating income as adjusted is \$28,121, and the Company's appropriate level of net operating income for return after our granted increase is \$73,787.

The Company's rate base is determined by the Commission to be appropriate for the purposes of this proceeding as set forth as follows:

TABLE A
ORIGINAL COST RATE BASE

MARCH 31, 1999

Gross Plant in Service	\$ 1,281,365
Accumulated Depreciation	<u>(205,603)</u>
Net Plant in Service	1,075,762
Meters & Supplies	9,811
Cash Working Capital	31,028
Contributions in Aid of Construction	(224,214)
Accumulated Deferred Income Taxes	<u>(29, 006)</u>
 TOTAL RATE BASE	 <u><u>\$ 863,381</u></u>

Both Staff and Company propose to book the effect of annualizing depreciation. The Staff recommends an adjustment of (\$2,260), and the Company, an adjustment of (\$2,728). The Commission adopts Staff's adjustment. (See discussion above.)

Further, both Staff and Company propose to allocate a portion of the general office and common plant to the upstate. Both Staff and Company recommend an adjustment of \$81,029 to utility plant in service, and an adjustment of (\$7,701) to accumulated depreciation for a total adjustment of \$71,068 to net plant in service. The Commission adopts these adjustments.

EVIDENCE AND CONCLUSIONS FOR FINDINGS

OF FACTS NOS. 8, 9, 10, AND 11.

Under the guidelines established in the decisions of Bluefield Water Works and Improvements Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in the Hope Natural Gas, decision, supra, the utility “has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.” However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues “sufficient to assure confidence in the financial soundness of the utility and . . . that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.” Bluefield, supra, at 692-693.

Neither S. C. Code Ann. §58-5-290 (1976) nor any other statute prescribes a particular method to be utilized by the Commission to determine the lawfulness of the rates of a public utility. For ratemaking purposes, this Commission examines the relationships between expenses, revenues, and investment in an historic test period because such examination provides a constant and reliable factor upon which calculation can be made to formulate the basis for determining just and reasonable rates. This method was recognized and approved by the South Carolina Supreme Court for

ratemaking purposes involving utilities in Southern Bell Telephone and Telegraph Co. v. The Public Service Commission of S.C., 270 S.C. 590, 244 S.E.2d 278 (1978).

For water utilities, the Commission may decide to use the “operating ratio” and/or “operating margin” as guides in determining just and reasonable rates, instead of examining the utility’s return on its rate base. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues. The obverse side of this calculation, the operating margin, is determined by dividing net operating income for return by the total operating revenues of the utility.

The Commission finds that its use of the operating margin has resulted in fair rates to both the utility and ratepayer. In this proceeding, the Commission will use the operating margin as a guide in determining the lawfulness of the Company’s proposed rates and the fixing of just and reasonable rates. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

The following Table indicates the Company’s gross revenues for the test year under the presently approved schedules; the Company’s operating expenses for the test year; and the operating margin under the presently approved schedules for the test year.

TABLE B

Operating Revenues	\$364,341
Operating Expenses	<u>\$308,087</u>
Net Operating Income (Loss)	56,254
Add: Customer Growth	<u>610</u>
Total Income for Return (Loss)	<u>56,864</u>
Operating Margin (After Interest)	<u>1.19%</u>

The Commission is mindful of those standards delineated in the Bluefield decision, supra, and of the balance between the respective interests of the Company and of the consumer. The Commission has considered the spectrum of relevant factors in this proceeding; the revenue requirements for the Company, the proposed price for which the Company's service is rendered, the quality of that service, and the effect of the proposal upon the consumer, among others.

With regard to the Hope and Bluefield standards requiring that this Commission establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility" and "to enable it to raise money for the proper discharge of its public duties," we find that we must establish rates in concert with these standards.

The three fundamental criteria of a sound rate structure have been characterized as follows:

...(a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292.

The Commission has considered the proposed increase presented by the Company in light of the various standards to be observed and the interests represented before the Commission. Based upon the record in the instant proceeding, the Commission

concludes that a fair operating margin that the Company should have the opportunity to earn is 10.42%, which requires annual operating revenues of \$422,073. The following Table reflects an operating margin of 10.42%:

TABLE C

Operating Revenues	\$422,073
Operating Expenses	<u>349,077</u>
Net Operating Income	72,996
Customer Growth	<u>791</u>
Total Income for Return	<u><u>73,787</u></u>
Operating Margin (After Interest)	<u>10.42%</u>

This Court, in its Order on Remand points out that the only evidence on rate of return in the record was presented by the Company, which sought approval of rates to produce additional revenues that would result in an operating margin of 10.42%. In actuality, Grantmyre, the Company's President recommended that the Commission set rates which result in an operating margin of at least 8.51% utilizing Heater Utilities' consolidated capital structure, or at least 11.0% using the Minnesota Power/Topeka capital structure. We believe the Minnesota Power/Topeka capital structure is more appropriate for use in this case, and as we apply our noted adjustments, the operating margin becomes 10.42%. (We hold that the Minnesota Power/Topeka capital structure most accurately reflects the capital structure of Upstate.) According to the testimony of Company witness Grantmyre, his recommendation compares to another of our granted operating margins of 13.86%. We note that, in this Company's previous rate case, we granted Upstate Heater an operating margin of 7.45%. Thus, although we disagree in principle with granting the operating margin of 10.42%, and have serious concerns about

the effect of the resultant rate increase on the Company's customers, we must follow the Circuit Court Order accordingly. We do note that this operating margin is supported by the record, and is comparable with Upstate Heater's past operating margin and the operating margin of the comparable company mentioned in Upstate Heater witness Grantmyre's testimony.

We note that, in recent years, our South Carolina Supreme Court has held that when an Order is remanded by the Circuit Court to the Commission, no appeal of that order may be taken until the Commission issues its Order on Remand. Following the issuance of this Order, an appeal is permissible. Accordingly, we instruct the Commission Staff to appeal the holding of the last Circuit Court Order, through an appeal of this Order at the proper time. We do not believe that the Circuit Judge gave proper credence to multiple factors that would have otherwise dictated a minimal rate increase in this case. We note that this Order will result in a 20.51% increase to the utility's consumers, which we think is excessive, but nonetheless feel obligated to put into effect under the Circuit Court Order on Remand.

In any event, our approved operating margin of 10.42% provides additional annual revenues of \$71, 836 after all approved accounting adjustments. The Commission holds that this additional revenue shall be derived by an increase in the monthly metered rates per single family equivalent as follows: the basic facility charge shall be increased to \$10.50, and the commodity charge per 1,000 gallons shall be increased to \$3.15. The water reconnection charge, new customer account charge, and the tap fee will remain the same. This rate structure appears in Appendix A attached hereto. The Commission finds that these rates and charges result in a reasonable attainment of

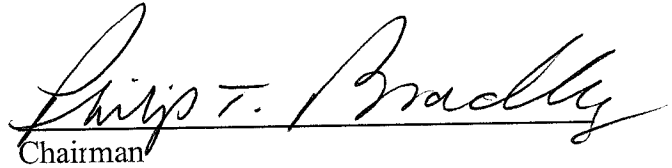
the Commission ratemaking objectives, in light of statutory safeguards, as interpreted by the Circuit Court. Again, we believe that we should have been allowed to have given more consideration to the interests of the consumers in this matter, but the ruling of the Circuit Court found that the only operating margin in the record that was usable was 10.42%, which we adopted. Again, Staff should appeal at the proper time.

IT IS THEREFORE ORDERED THAT:

1. The originally proposed schedule of rates and charges by the Company is found by us pursuant to Court Order to be reasonable, and is hereby granted.
2. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. The schedule is deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (1976), as amended.
3. The Company shall maintain its books and records for water operations in accordance with the NARUC Uniform System of Accounts for Class B Water Utilities, as adopted by this Commission.
4. The Commission Staff shall appeal the last Circuit Court Order in this matter through the appeal of this Order at the proper time.

5. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Chairman

ATTEST:


Executive Director

(SEAL)

APPENDIX A

UTILITIES OF S.C., INC.
F/K/A UPSTATE HEATER UTILITIES, INC.
104 CORPORATE BLVD., SUITE 411
W. COLUMBIA, SC 29169

DOCKET NO. 97-304-W
ORDER NO. 1999-147
EFFECTIVE DATE: MARCH 1, 1999

WATER RATES AND CHARGES

Metered Rates (per single family equivalent:

Basic Facility Charge (monthly)	-	\$ 10.50
Commodity Charge (per 1,000 gal.)	-	\$ 3.15
Water Reconnection Charge	-	\$ 30.00
New Customer Account Charge *	-	\$ 22.00

* One time fee charged to each account to defray cost of initiating service.

Tap Fee *	-	\$500.00
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* The full gross up will be added to the tap fee.